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"A lot of sectors have moved into reasonable valuation zone"

Mid and small-caps are still trading lower than at the end of 2017, providing opportunities for bottom-up stock picking in these two pocket, Nimesh Chandan tells **Sanket Dhanorkar**.

Nimesh Chandan
Head - Investments, Equities, Canara Robeco MF

How do you perceive the market situation after the wild swings of the past 6-8 months?
We have seen the market swing from panic and fear in April to hope and optimism in October. The market has recovered quickly, but it has moved up in a very logical fashion. At the beginning of the year, investors moved away from companies in which China was part of the value chain to companies that were competing with China as a substitute. When the pandemic spread, investors moved to companies which would be immune to the disruption or where impact would be negligible. After the huge fiscal and monetary support given by various countries, export driven companies got traction. As India began to open up, we saw gains in companies that saw pent-up demand and improvement in business. Now investors are looking at companies which will do well next year when life will be back to usual. Expectations are that next year normalcy will return. If there is any dip in this recovery, we may see a correction.

With improvement in key economic indicators, can we assume recovery is entrenched?
Currently, most indicators are showing good recovery. However, not all sectors were affected equally. Some sectors were less affected by the pandemic. Those companies continue to deliver on their growth trajectory. Some companies in the consumer sector have seen pent-up demand. The strength of this recovery will be fully tested after the festive season. Further, the recovery currently is in terms of going back to normal rather than to a higher growth trajectory. For estimating higher growth, we need to go into individual company merits. Companies that are leaders in their segment will be able to use this time to increase the market share and achieve better growth than the rest. Industry leaders typically will be able to invest in technology, distribution, raise capital and invest even during these times.

How do you perceive the current valuations across market segments?
In March, companies were trading at very cheap valuations. However, as optimism has come back, a lot of sectors have moved to reasonable valuation zone. Few sectors have already moved to the upper end of the valuation band. Valuations depend on the business model, quality of balance sheet, returns ratios and growth rates. Company valuations will align along these parameters. Overall, we have moved to reasonable valuations in the large cap space, pricing in a normalisation for next year. Some of these companies may be vulnerable in terms of valuations. Mid and small caps are still trading lower than at the end of 2017, providing select opportunities for gains.

> *Some sectors were less affected. These firms continue to deliver on their growth trajectory.*

How is the mid- and small-cap segment placed after the pain of the past two years?
It is difficult to generalise for the entire space. But there are definitely opportunities for bottom-up stock picking in these two pockets. Going forward, companies with leadership in their brand or niche segment will be able to navigate through these times and deliver better returns. Companies with a strong brand franchise can do well. This pandemic has accelerated the move from unorganised to organised sector. There are companies that can benefit from this shift.

What are the sectors or themes that you are backing now?
Three themes will play a key role in coming years. First, within the domestic market, rural India will do very well. This year we have had a good monsoon. Government policies will help improve rural income. There will be improvement in infrastructure development which will also help rural economy. Secondly, government push for manufacturing in India will help in export promotion and import substitution. India will become more competitive in manufacturing and this will show up in the numbers. Thirdly, we will see return of inflation globally. That will help companies in the materials sector and will start contributing to the profit pool of India Inc.

Is the global low interest rate environment likely to keep fueling asset prices?
Theoretically, with lower interest rates you see higher valuations for equity markets. But in practice, very low interest rates don't lead to peak equity valuations. When interest rates are at mid-range, equity valuations can go up. When interest rates are extremely low, it is in response to a global or domestic issue on growth. When growth is low, equities don't reach peak valuation. When interest rates are very high and growth is also high, the discounting comes into play and result in lower valuations compared to peak. The sweet spot is in the mid-range of interest rates where you see growth coming back and policy continues to be accommodative for some time. I believe we will enter such a scenario once this pandemic is over. This will be good for the markets.

All your equity funds have been outliers over the past year. What has contributed to this performance?
Having a good investment process and following it with discipline is the key to investment success. Over the years, we have followed a process that helps us identify robust, growth-oriented businesses with competent management available at reasonable valuations. We have a strong quality focus. Internally, we also use tools and ideas from behavioral finance to improve our decision making. In the past year, we have not done anything different than trying to select the best companies that come through our screeners. We have been bullish on certain sectors like pharmaceuticals for past few years. Certain investments in consumer sector and private banks have also contributed to the funds' performance. We have also been able to avoid companies that have weak balance sheets or are over-leveraged. That has helped restrict drawdowns.

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